Office of Chief Counsel
Internal Revenue Service

memorandum

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HNAdams

date: July 24, 2000

to: District Director, Connecticut-Rhode Island
Attn: Jo Ann Prager, Technical Advisor, Leasing Promotions

from: District Counsel, Brooklyn

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subject: Leasing ISP Request for Advice - Preparing Statutory Notice of Deficiency Where Alternative Position Produces Greater Deficiency in One of the Years at Issue then Primary Position

UIL Nos.: 6214.02-00, 7453.32-00

This memorandum is in response to your June 16, 2000 request for advice on the issue of how examination teams should handle situations in which an alternative position that they are taking to adjust results claimed from lease stripping transactions produces a greater deficiency for one or more of the years at issue than does their primary position.

DISCLOSURE STATEMENT

THIS DOCUMENT SHOULD NOT BE DISCLOSED TO ANYONE OUTSIDE THE INTERNAL REVENUE SERVICE. IT MAY INCLUDE CONFIDENTIAL INFORMATION SUBJECT TO THE ATTORNEY-CLIENT AND DELIBERATIVE PROCESS PRIVILEGES, AND MAY ALSO HAVE BEEN PREPARED IN ANTICIPATION OF LITIGATION.

BACKGROUND

Lease stripping transactions generally involve a step in which the income relating to leased assets is separated from the deductions (for example depreciation) relating to the assets. The income from the leased assets is typically stripped off in year 1 to an individual or entity that is not subject to U.S. income tax and the deductions are then taken by a taxable party over the life of the transaction (years 1, 2, 3, and so on). The Service attacks the transactions by asserting a number of alternative theories. Commonly, our primary position is that the transaction is a sham. That position results in the disallowance of the deductions claimed in years 1, 2, 3 and so on. An alternative to our primary position that the transaction is a sham frequently results in requiring the party claiming the deductions to report the stripped income. That

alternative position may produce a greater adjustment in year 1 than our primary position.

ISSUE

How should examination teams handle the situation in which an alternative position produces a greater adjustment in one of the years at issue than the primary position?

CONCLUSION

Examination teams should issue a separate notice of deficiency for years in which an alternative position produces a greater adjustment than the primary position. In the separate notice of deficiency, the alternative position that produces the greatest adjustment should be made the primary position for that year so that the deficiency will be computed based on that adjustment. The position that is the primary position for the remaining years and other alternative positions should then be stated as alternative grounds in support of the deficiency determined in the separate notice.

DISCUSSION

Under Tax Court Rule 142(a), taxpayers generally have the burden of proof in Tax Court cases. In contrast, Tax Court Rule 142(a) imposes upon the Service the burden of proof with respect to increases in deficiency above the deficiencies determined in notices of deficiency. In some cases, the allocation of the burden of proof can decide what party prevails. See, e.g., Markle v. Commissioner, 17 T.C. 1593, 1599 (1952)(sustaining deficiency determined in notice of deficiency based on theory that amount was allowable as a nonbusiness bad debt but holding that respondent had failed to carry his burden of proof with respect to increased deficiency that would result from theory that no deduction was allowable because amount was capital contribution); Tennessee Consolidated Coal Co. v. Commissioner, 15 T.C. 424, 432 (1950)(holding salary deductible to extent respondent had burden of proof); Margolis v. Commissioner, T.C. Memo. 1999-24, aff'd per curiam without published opinion, 2000-1 U.S.T.C. ¶50,432 (4th Cir.)(holding that Service failed to prove entire amount of increased deficiency asserted after issuance of the notice of deficiency); Shaller v. Commissioner, T.C. Memo. 1984-584, aff'd per curiam without published opinion, 813 F.2d 403 (4th Cir. 1986)(holding for taxpayer to the extent the Service had burden of proof).

To preclude the allocation of the burden of proof to the Service on the increased deficiency that would result if the Court decides for the Service on an alternative position that produces a

greater deficiency in one of the years of a lease stripping transaction than the Service's primary position with respect to the transaction, we recommend that examination teams issue a separate notice of deficiency for years in which an alternative position produces a greater adjustment than the primary position. In the separate notice of deficiency, the alternative position that produces the greatest adjustment should be made the primary position so that the deficiency will be computed based on that adjustment, and the primary and other alternative positions should be stated as alternative grounds in support of the deficiency.[1]

Under routine procedures that have been established for opinions of this type, we have referred this memorandum to the Office of Chief Counsel for review. That review might result in modifications to the conclusions herein. We will inform you of the result of the review as soon as we hear from that office. In the meantime, the conclusions reached in this opinion should be considered to be only preliminary.

Any questions regarding this opinion should be referred to Halvor Adams on (516)688-1737.

JODY TANCER
Acting District Counsel

[1] We recognize that the position that the taxpayer must recognize the income relating to a lease stripping transaction may be viewed as inconsistent with the position that the taxpayer is not allowed the deductions relating to the transaction because the transaction was a sham. The Service is entitled to take alternative inconsistent positions in notices of deficiency for purposes of protecting the revenue without causing the determinations to lose their presumptive correctness or shifting to the Service the burden of proof. Guest v. Commissioner, 77 T.C. 9, 17-18 (1981); Harrison v. Commissioner, 59 T.C. 578, 592 n.13 (1973).